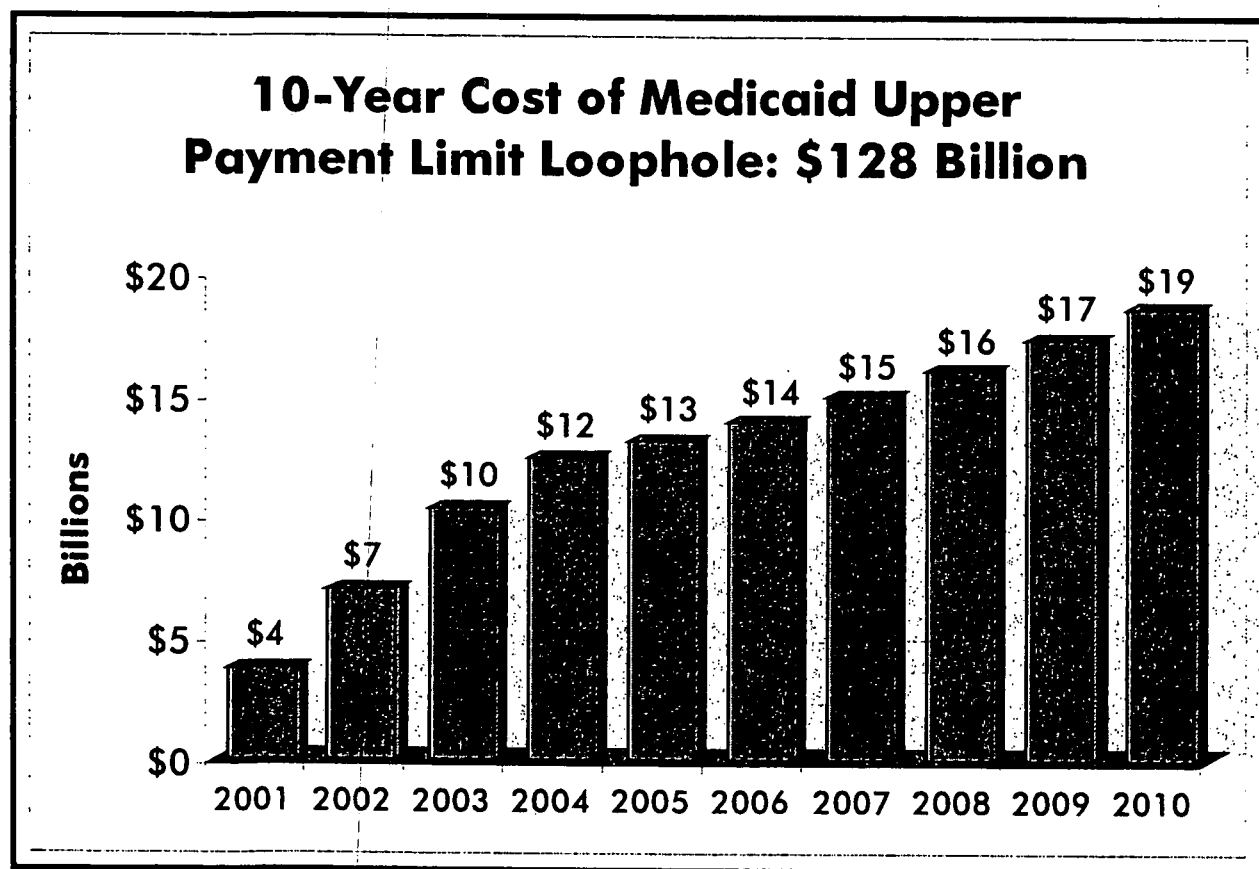


October 13, 2000

States Are Looting Medicaid Through a Multi-Billion-Dollar Loophole

Medicaid is the joint federal-state program that provides health care to 40 million low-income Americans. As a result of a loophole in the Medicaid law, a few states are bilking taxpayers in other states for billions of dollars and spending federal Medicaid funds on things that have nothing to do with health care. Congress and the Administration must close this loophole both to restore the integrity of the Medicaid program and to protect taxpayers.



Source: Congressional Budget Office

Like similar Medicaid scams in the past, the accounting gimmicks used are so arcane and dull as to make any accountant's eyes glaze over. Here is an executive summary of how some states are abusing what are known as "upper payment limit" arrangements (see also appendix):

Essentially, a loophole in the law allows a clever state to overcharge the federal government for certain Medicaid services and then reroute the funds to anything from bridges and roads to tax cuts.

While technically legal, this practice violates two tenets of the Medicaid program:

- **First, Medicaid exists to provide health care to the poor, not a free-flowing source of funds for other priorities.** According to the Health Care Financing Administration (HCFA), the federal Medicaid agency, "this practice appears to be creating rapid increases in Federal Medicaid spending, with no commensurate increase in Medicaid coverage, quality, or amount of services provided." States have so far used ill-gotten federal Medicaid dollars to fill budget gaps, reduce state debt, finance tax cuts, and fund education programs — all with money that came from taxpayers in other states.
- **Second, Medicaid is a shared responsibility of the federal and state governments, who each contribute to the program according to laboriously considered rules.** The General Accounting Office (GAO) warns states that use this loophole "violate the basic integrity of Medicaid as a joint federal/state program." The non-partisan Congressional Budget Office (CBO) estimates that the 19 states are already engaged in this scam — and nine more poised to join them — **will overcharge federal taxpayers \$3.7 billion next year, \$46.6 billion over five years, and \$127.6 billion over 10 years.** Unless this loophole is closed soon, additional states will follow suit, sending the cost of this loophole even higher.

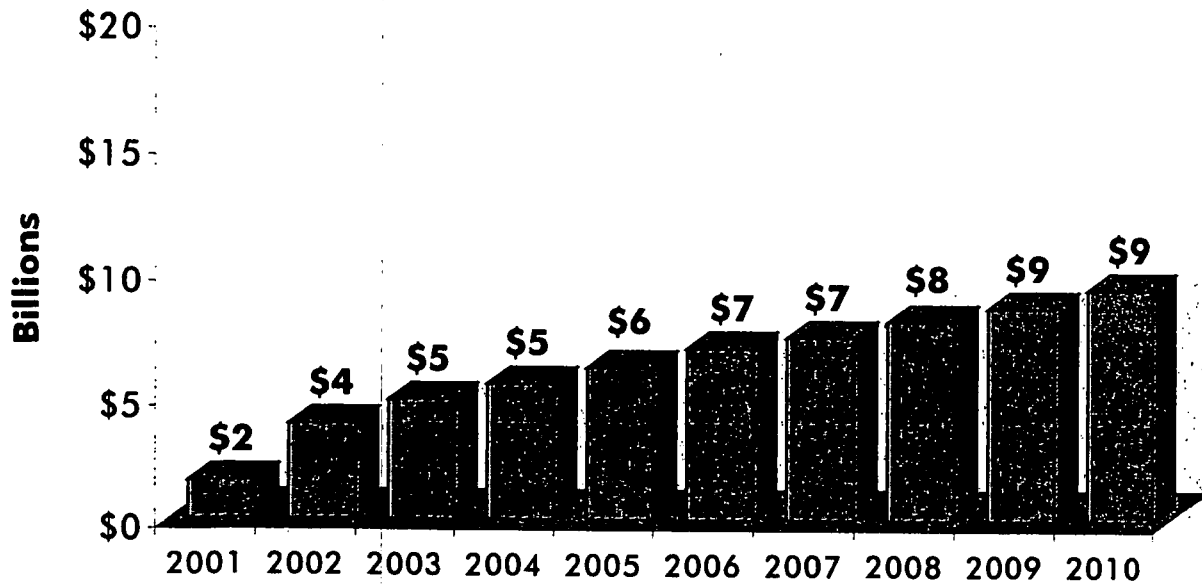
The potential for damage to Medicaid and the federal budget is so staggering, budget-watchers from the GAO to the left-leaning Center on Budget and Policy Priorities (see appendix) have called on Congress and the Administration to close this loophole.

HCFA: Tighten, But Don't Eliminate the Loophole

Recognizing the need to stop this practice, the HCFA has proposed to tighten — though not eliminate — the loophole. The agency's proposed regulation would place a limit on the excess amount a state may charge the federal government, but would allow states to continue to do so in perpetuity. As a result, states could continue funding their own governments with money taken from taxpayers in other states and continue threatening the "basic integrity of Medicaid as a joint federal/state program."

Despite its shortcomings, however, legislative efforts to stop the HCFA from finalizing the proposed regulation would be fiscally irresponsible. According to the CBO, **this regulation would save federal taxpayers \$1.5 billion in 2001, \$21.5 billion over five years, and \$61.3**

10-Year Savings from HCFA Fix: \$61 Billion



Source: Congressional Budget Office

billion over ten years. Blocking the regulation would likewise rob taxpayers of the same amount. Though imperfect, the HCFA's proposed regulation is at least a first step.

The Only Real Solution: Close the Loophole

Finance Committee Chairman Bill Roth (R-DE) has introduced legislation (S. 3187) that would gradually and completely close this loophole over two years. Undoubtedly, states that have become accustomed to these funds will object to this approach. However, those states are always free to lobby Congress for more Medicaid funding — and they should do so above the table, rather than defend an underhanded scheme that robs taxpayers in other states blind.

Closing this loophole will protect Medicaid for 40 million low-income Americans and save taxpayers \$128 over the next ten years. Until Senator Roth's or similar legislation can be implemented, HCFA's proposed regulation is the best available means to stop this abuse of Medicaid.

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Appendix

Here is the Center for Budget and Policy Priorities' explanation of how states abuse "upper payment limits":

"Under this financing mechanism, a state pays selected nursing homes, hospitals or other institutions more than the actual costs the facilities incur for medical services they provide. The state then requires these health care providers to transfer most of the extra payments back to the state. The state draws down federal matching funds based on the inflated payments it has made to the providers. As a result, the state collects additional federal money without contributing any state funds. The federal Medicaid funds gathered through these schemes can be used by states for any purpose they choose, including for activities that are neither related to health care nor authorized by Congress."

Leighton Ku, "Limiting Abuses of Medicaid Financing: HCFA's Plan to Regulate the Medicaid Upper Payment Limit," Center for Budget and Policy Priorities, <http://www.cbpp.org/9-27-00health.pdf>, September 27, 2000, p. 1.